No. 10,473

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

BYRON JACKSON CO., a corporation,
Appellant,

vs.

PATTERSON-BALLAGH CORPORATION, a corporation, J. C. BALLAGH and D. G. MILLER,
Appellees.

APPELLANT'S REPLY BRIEF.

CHICKERING & GREGORY,
DONALD Y. LAMONT,
FREDERICK M. FISK,
STEPHEN R. DUHRING,
111 Sutter Street, San Francisco, California.
LYON & LYON,
LEONARD S. LYON,
IRWIN L. FULLER,
810 West Seventh Street, Los Angeles, California.
Attorneys for Appellant.

FILED
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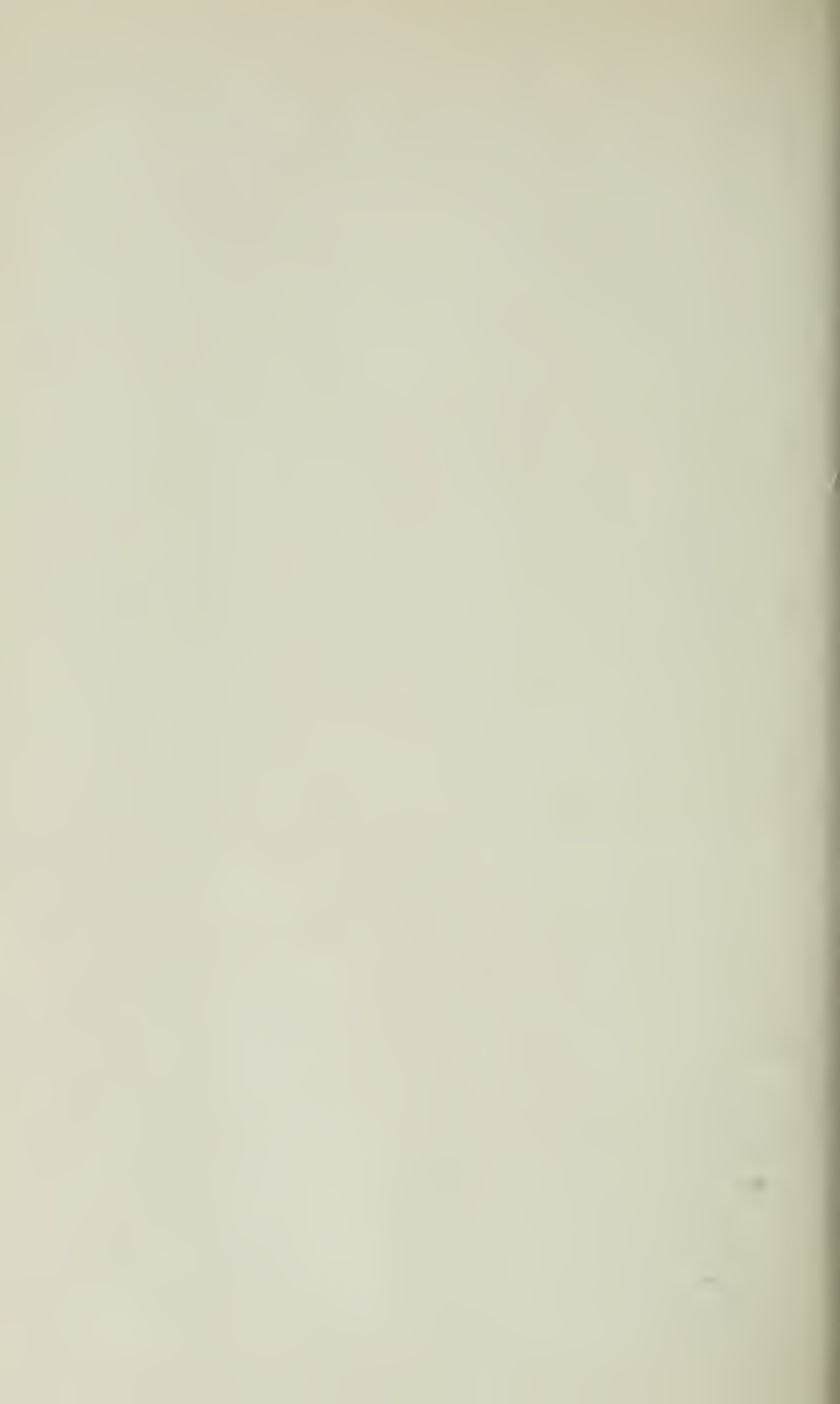
PAUL P. O'BRIEN,
CLERK



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APPELLANT'S REPLY BRIEF.

Thirty-six pages of appellees' brief are devoted to discussions of the scope of the reviewing power of this Court, the nature of the action (whether at law or in equity), and the burden of proof. These are all interesting subjects and have a bearing on this case. We have discussed them in our opening brief and will again deal with them. We think it more important to first examine, in light of counsel's brief, the uncontradicted proof as appearing in this record.

I. DEFENDANTS' ONLY ATTEMPT TO JUSTIFY THEIR EXCESSIVE SALARIES IS BY RESORT TO THEIR CLAIMED INVENTIONS.

In defendants' brief there is not one claim that defendants' salaries can be justified in any manner other than by resort to inventions. A reading of the brief will not only demonstrate the absence of any claim that the salaries can be otherwise defended but at numerous points this is conceded.

Commencing at the bottom of page 63 of their brief there is the following:

> "They (the defendants) do contend, however, that they are entitled to compensation for their services as president, General Manager and for the development of inventions and devices so far as Miller is concerned, and as secretary-treasurer, Sales Manager and the development of devices and inventions so far as Ballagh is concerned, paid in each case as a unit and not split up into separate categories as in the *Stratis* case, *supra*," etc. (Underscoring ours.)

On page 49 counsel deal with the testimony of Mr. Burrell, the company's attorney, and state as follows:

> "As to the compensation to both Messrs. Ballagh and Miller in so far as the matter of inventions was a factor, it was Mr. Burrell's opinion that the inventions belonged to the inventors in the absence of assignments or licensing agreements. He testifies that they either had been or would be transferred as soon as invented or as soon as patents were applied for (R. 449) and that it was distinctly to the company's ad-

vantage to compensate Ballagh and Miller for the use of these inventions on a salary basis which was flexible from time to time depending upon the general condition of the business, rather than to definitely obligate the company to pay royalties under licensing agreements (R. 450-451)."

Numerous other illustrations of the foregoing are to be found upon pages 44, 46, 48, 51, 54, 55, 56, 60, 61, 65, 66, and 67 of the brief.[1]

It is not surprising that counsel are forced to rely upon inventions. For the fiscal year 1940 the defendants took from the corporation over $48,000 in salaries. For the fiscal year 1941 defendants took from the corporation over $53,000 in salaries. As pointed out in our opening brief, for the year 1940 defendants

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[1]Counsel, upon pages 61 and 62 of their brief, discuss *Stratis v. Anderson*, 254 Mass. 536, 150 N. E. 832. Their claim that this case is not in point must be due to a misunderstanding. The *Stratis* case held that when an employee of a corporation is compensated in separate amounts for his services as treasurer, for his services as general manager, and for his services as clerk, his excessive compensation in one capacity cannot be justified by his underpayment in another capacity.

The case is absolutely in point. Ballagh and Miller were being compensated as president and general manager and as secretary, treasurer and sales manager. They were not being compensated as inventors. The minutes so demonstrate. Suppose that each of these gentlemen had been paid $1,000.00 a year for his services as president and general manager or secretary, treasurer and sales manager, and suppose that they had also been employed as inventors, for which services they were paid the remaining $48,000.00; their compensation in the latter capacities could not have been justified by the underpayment in the former capacities. This is precisely what the *Stratis* case holds. The present record is even more extreme. They were not even employed as inventors.

We are wondering if Ballagh and Miller had refused to work upon inventions, counsel would maintain they had violated their contracts and should have been discharged.

took unto themselves 70%, and for the year 1941 74%, of the net profits of the corporation. During these years the entire capital and surplus of the corporation was only a little over $200,000. Defendants, during each year, were taking unto themselves an amount equivalent to one-fourth of the entire capital and surplus. The situation is there.

Appellant does not have to resort to the Bunch exhibit. A mere appeal to the general knowledge, common sense, and experience of this Court is sufficient.

Thus defendants are obliged to inject some extraordinary circumstances that do not exist in the normal corporation. They, therefore, rely upon inventions. We again examine the inventions.

II. DEFENDANTS' INVENTIONS CANNOT JUSTIFY EXCESSIVE SALARIES.

1. DEFENDANTS IN ONE BREATH CLAIM THAT THEIR INVENTIONS WERE PROPERTY RIGHTS WHICH, UNTIL CONVEYANCE TO THE CORPORATION, BELONGED TO THEMSELVES. IN THE NEXT BREATH, THEY CLAIM THAT THEIR INVENTIONS CONSTITUTED SERVICES RENDERED TO THE CORPORATION.

This is no better illustrated than by quoting from counsel's brief. On page 72 there is the following:

> "It remains perhaps to establish that the devices and inventions developed by Messrs. Miller and Ballagh originated under circumstances which constituted them their individual property both as to the element of use or so-called 'shop rights'

and also from the proprietary standpoint and that, in conferring their free use upon the corporation and in assigning their present and future proprietary interest thereto, they were parting with property rights of value. (Underscoring ours.)

Just across on page 73, there is the following:

"However, the individual defendants devised these inventions with the sole idea and for the sole purpose of improving the company's business and making it the beneficiary in so far as their royalty free use was concerned, and, in addition thereto, conferred the proprietary ownership upon the company. If this does not constitute the rendition of 'services' we do not understand the meaning of that term and, in our opinion, this argument of appellant characterizes and should discredit its case *in toto*." (Underscoring ours.)

Apparently counsel produce a legal hybrid. It has always been our understanding that services are different than property rights, and *vice versa*. We do not understand how an invention can at the same time be both. We are dealing with, not only a hybrid, but an afterthought introduced into this litigation for the first time at the trial in an attempt to justify salaries that can not be justified.

Nevertheless, counsel force us to consider both alternatives; to-wit, the alternative that the inventions constituted property rights belonging to the defendants, and the alternative that the inventions constituted services rendered to the corporation.

(a) The alternative that the inventions constituted property rights.

We have always believed that this is the correct alternative. A patent is property. (*United States v. Dubilier,* 289 U.S. 178.) Commencing at page 35 of our opening brief, we correctly stated that there was no action by the Board of Directors employing the defendants as inventors, without which no reliance in support of salaries could be placed upon inventions. We also showed by the uncontradicted testimony of the defendant Ballagh and of the corporation attorney, Burrell, that the defendants never had any contract to perform such services for the corporation and that when the so-called inventions were perfected they were the property of the defendants, which they could or could not transfer to the corporation, as they saw fit. We, therefore, thought that it was impossible to claim that the inventions were services rendered to the corporation, or that they were services at all. This we submit upon our opening brief.

(b) The alternative that the inventions constituted services rendered to the corporation.[2]

We argued in our opening brief that even if the inventions of the defendants could be considered as services, they are not of sufficient value to support

[2]Counsel, on page 64 of their brief, say that they are wholly at a loss to understand appellant's argument that if services were performed by the defendants such services were performed for themselves and not for the corporation. We concede that counsel have failed to understand our argument. They draw the absurd conclusion that our argument was "all for the purpose of showing that for the compensation paid by the corporation to the inventors, the corporation gained great value which it otherwise would not have received and owned". Not in this respect but in

the amount of the salaries. We will hereafter again consider this.

Counsel claim on page 4 of their brief that Miller was never elected general manager and that Ballagh was never elected sales manager. A statement on page 60 of their brief is entirely inconsistent for there they point out, which was the fact, that on February 15, 1939, at a directors' meeting, Miller was designated general manager and that at a meeting of the Board held on March 18, 1940, it was pointed out that the duties of Ballagh also included that of sales manager. Be this as it may, we are unable to believe that the absence of the employment of these two gentlemen as inventors can be remedied by what may or may not appear in the minutes as to general manager or sales manager.

The Ballagh inventions. Ballagh, in so far as receiving salary was concerned, was the greater of the two offenders. Irrespective of the value of his inventions, there is another conclusive argument that they can not be used to bolster up his salary. The peak of the misappropriation of moneys from the corporation by paying excessive salaries was during the years 1940 and 1941. It is axiomatic that, except by specific contract, salaries during those years can only be for services rendered during those years. The

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another respect our argument may be misleading in that it hypothetically attempts to consider the inventions as services when they were not services at all, but were property rights belonging to the defendants and which were transferred to the corporation just as any chattel or piece of real estate could have been transferred.

inventions upon which Ballagh relies were all perfected either prior to 1939 or during the early part of that year. Before the beginning of 1940, they were well under way.[3] We will consider in turn each invention upon which any emphasis is laid and in the order of the importance which counsel ascribe to them.

The lip protector. There was a sale of this lip protector in 1939. Ballagh so testifies at page 366 of the record. At page 514 he testified that a few of the lip protectors were sold in 1939. Defendants' Exhibit "A",[4] to be found opposite page 10 of this brief, shows that many sales of lip protectors occurred in 1940.

The hydraulic applicator. This applicator was developed before the lip protector, at some time during the years 1936-1938, probably in 1938. At any rate, it had been perfected prior to 1939. At page 455 of the record, the witness Burrell, the corporation's attorney, testified that during the period from 1934 to 1938, he practically lived with the applicator, and that for the last two years of this period he was working on the hydraulic applicator. Ballagh testified that an application for a patent was filed in 1939 (R. 492) and that work had commenced in 1938. There are also other references in the record. (R. 430-431; 460; 462; 531.)

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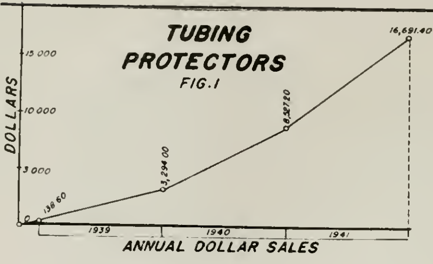
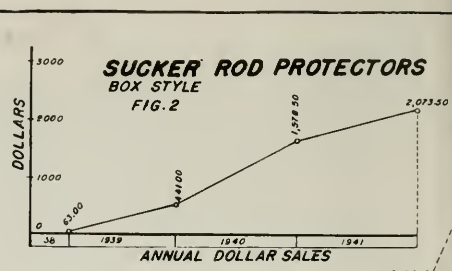
[3]Counsel, at page 5, of their brief, mention references in the minutes to inventive work. The last minutes containing any reference to any such work (we do not know by whom) was December 20, 1938. The conclusion to be drawn therefrom is in exact accord with the above argument.

[4]The only exhibits that plaintiff invokes in this brief are defendants' own exhibits.





PIPE WIPERS
FIG. 3

DOLLARS

50,000
40,000
30,000
20,000
10,000

43,862.20
30189.50
12,296.00

1939 1940 1941

ANNUAL DOLLAR SALES

143,124.10

ACCUMULATED TO END OF 1941
119,264.90

ACCUMULATED TO END OF 1940
56,627.80

ACCUMULATED TO END OF 1939
18,232.60

ACCUMULATED TO END OF 1938
201.90

1938 1939 1940 1941 1942

DOLLARS

143,124.10
GROSS
SALES
TO
JUNE 1-1942.
ACCUMULATED

GRAPHIC CHARTS INDICATING
THE YEAR BY YEAR INCREASE IN DOLLAR SALES
OF
ROYALTY-FREE INVENTIONS
OF J.C. BALLAGH
OTHER THAN THE INVENTIONS
OF THE LIP PROTECTOR AND HYDRAULIC APPLICATOR

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The pipe wiper; the tubing protector; the sucker rod protector. These items are the only other so-called inventions that either Ballagh or his counsel stress.[5] We consider them together because defendants' Exhibit "G" shows conclusively that they all came into being at the latest in 1939 and probably prior thereto. For the Court, we set opposite a photostatic copy of defendants' Exhibit "G" with the comment that as to what we are establishing it is conclusive, but that as to another phase of the case it is misleading. The curves as shown thereon are cumulative, and unless the word "accumulated" as printed thereon is observed, the importance of these three inventions can be many times magnified.

In addition, at page 370 of the record Ballagh testified that he started work in 1938 upon the pipe wiper and that he thought the first sales were made in that year. At page 527 he testified that Exhibit "G" directly portrayed the volume of gross sales of the sucker rod protectors from 1939 to 1941. We have been able to find no data as to tubing protector except Defendants' Exhibit "G", which is therefore uncontradicted. So that the Court may fully understand the relative unimportance of the inventions

[5]Counsel, at page 47 of their brief, mention the Kelly wiper and the plastic tubing protector. These items were trivial. Defendants' Exhibit A shows that in the year 1941 only approximately $1000 worth of Kelly wipers were sold (none appear prior thereto), and Exhibit A does not even mention the plastic tubing protector as a distinct item. Furthermore, the first sales of the plastic tubing protector were made in 1938 (R. 523), and the Kelly wipers, according to Ballagh's own testimony, amounted to nothing more than a larger size of the pipe wiper. As above set forth, the pipe wiper came into being prior to 1939.

listed upon Exhibit "G", we again refer the Court to the photostat of Exhibit "A" inserted opposite.

We have gone further than necessary. At page 48 of counsel's brief the following appears:

> "All of these devices were developed and placed on the market from about the beginning of 1939, * * *"

Thus we find that even if Ballagh could resort to his five claimed inventions they would not bolster up salaries for the years 1940 and 1941. It would be novel if an employee, without any contract with a corporation, could make claim for huge amounts for services in the years 1940 and 1941, when those services were not rendered in those years, but had been rendered during prior years. The minutes do not show any resolution passed during any prior year whereby services rendered in any such year were to be thereafter and in subsequent years compensated. We are wondering, if the defendant Ballagh had left the employ of the corporation upon December 31 of 1939 he would have made claim for compensation for later years, and if so, how many subsequent years he would have mentioned. Was he to have a pension for his life, or a pension during the life of the patents, or what not?

Ballagh testified that it was much better for the corporation to pay large salaries rather than to pay royalties (R. 45; 453-454) and thus attempted to excuse the excess, but this theory was never em-

1938	1939	1940	1941

GROSS ANNUAL SALES DISTRIBUTION BY ITEMS AND INVENTIONS.

1938
312,979.11

- LINE GUIDES 26,944.55 — ROYALTY 1108 06
- SWIVEL BUMPERS 5766.44 — 834.82
- MUD GUNS 5468.50
- MISC
- INSTALL. EQUIP 14,460.75
- CASING PROTECTORS (WITHOUT LIPS) 239,208.06 — 10,870 25
- 12,813 13 TOTAL
- BOX SUCKER ROD PRO 1,630.60 — 38 60
- TUBING PRO
- J C B

1939
336,527.88

- LINE GUIDE 33,522.18 — ROYALTY 730 12
- SWIVEL BUMPERS 11,633.33 — 1770 22
- MUD GUNS
- MUD GUNS 5983.51 — 45.99
- MISC
- INSTALL EQUIP 3426.70
- CASING PROTECTORS (WITHOUT LIPS) 261,741 70 — 10,615 00
- 13,181.33 TOTAL
- Tubing Protectors 3294 00
- PIPE WIPERS 12,298 00
- J C B HYD APP 7%
- SALE OF J.C. Ballagh Inventions 16,041 00 47%

1940
329,621.51

- W LINE GUIDES 32,654.90 — ROYALTY 436.82
- SWIVEL BUMPERS 7 787.81 — 658.77
- MUD GUNS 2863 65 — 228 26
- MUD GUNS no royalty 5115 79
- MISC 1970 29
- INSTALL EQUIP 2147 72 — 38 95
- Sucker Rod Wip 389 50
- CASING PROTECTORS (WITHOUT LIPS) 70,738 23 — 8782 50
- 10,367.30 TOTAL

SALE OF J.C. BALLAGH INVENTIONS 203,295.20 = 62%

- LIP PROTECTORS 163,000 (EST 70%)
- SU. ROD PRO 1578 50
- TUBING PROTECTORS 8527 20
- PIPE WIPERS 30,188 30

1941
366,420.87

- LINE GUIDES 34,938.84 — ROYALTY 412 38
- SWIVEL BUMPERS 6111 45 — 665 32
- MUD GUNS 3287 95
- INSTALL EQUIPMENT
- MISC — 38 45
- CASING PROTECTORS (WITHOUT LIPS) 17,012 22 — 8891.83
- 10,007 96 TOTAL

SALE OF J.C. BALLAGH INVENTIONS 289,949.50 = 78.6%

- CASING PROTECTORS (WITH LIPS) 228,000 (EST 83%)
- TUBING PROTECTORS 16,691 40
- KELLY WIPERS
- D PIPE WIPERS 43,882.20

TOTAL ROYALTY PAID

PAID TO	ITEM	1938	1939	1940	1941
REID	WIRE LINE GUIDE	1,108 06	730.18	436 82	412 38
DYE & NEGEARIS	SWIVEL BUMPER	834 82	1,770 22	658 77	665 32
TUEL	MUD GUN	—	45 99	228 26	—
O'DELL	SUCKER ROD WIPER	—	—	38 95	38 45
O-J & CONTINENTAL	PROTECTORS	10,870 25	10,615 00	8 782 50	8,681 83
TOTALS		12,813 13	13,181 33	10,367 30	10,007 96

EXHIBIT No. 17 Filed 1946 Clerk Deputy

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PAUL P O'BRIEN

bodied in any resolution of the Board of Directors, no contract was produced; it was never mentioned to the Board of Directors.

Counsel refer to page 59 of the record, to our "puerile wail" that nothing was stated in the pleadings as to inventions, and that these inventions were first brought to light at the time of trial. There is more force to our statements than counsel realize. If the defendant Ballagh had been paid a salary not greater than warranted by his duties as Secretary-Treasurer and Sales Manager, and the balance of the compensation had been in the purchase and sale of inventions and patents, our action would have been for rescission of these transfers and for a refunding to the corporation of the moneys paid.

The Miller inventions. No weight can be given to these claimed inventions. At pages 46 and 47 of our opening brief we pointed out that they were infinitesimal. For the year 1940, out of gross sales of over $329,000, the sales that could be attributed to his inventions were only approximately $2,600, and in 1941, out of gross sales in excess of $366,000 the figure that could possibly be attributed to Miller was only approximately $6,000. The relative unimportance of his claim is best illustrated by reference to the defendants' Exhibit "A". The Miller inventions are shown at the very bottom of the 1940 and 1941 columns. In the original of Exhibit "A" they are shown in yellow.

The value of the Ballagh and Miller inventions. This subject is covered on pages 42-47 of our open-

ing brief, and counsel have given no convincing answer. We again bring up the same in light of defendants' Exhibit "A". That exhibit is misleading as to lip protectors. We quote from page 44 of our opening brief:

> "The casing protector business had existed ever since the formation of the Corporation; in fact had been taken over from the original partnership of Patterson & Ballagh. The defendants claim, however, that by invention they had improved the old casing protector by placing at each end thereof a so-called 'lip'. This was but a trivial improvement (R., 367). Not only does the testimony of the witnesses Chestnut and Grant so state (R., 544-545), but an examination of Exhibit E will so demonstrate.
>
> There is no showing that the Corporation's business would not have proceeded equally well without the claimed invention and, for that matter, no (*material number of*) lip protectors were sold in the year 1939 (R. 366), yet the protector business for that year substantially exceeded the protector business for the year 1940 and also for the year 1941. The witness Burrell admitted that the lip protector did not increase the protector business (R., 454)."

III. QUANTUM MERUIT.

At times counsel seems inclined to invoke *Quantum Meruit*. There are several answers.

(a) Numerous authorities are that when an officer performs services outside of his duties,

he must have a contract with the corporation before he can recover for such services. We cited these authorities upon page 40 of our opening brief.

(b) Section 3 of Article III of the By-laws precludes any such possibility. That By-law states "until the salary of an officer has been fixed by resolution of the Board of Directors, such officer shall serve without compensation" (R. 108). *Quantum Meruit* is based upon an implied contract. The By-law negatives any possibility of such implication.

(c) The defendants were dealing with themselves and prescribing by express resolution (contract) the amount of their salaries as president and general manager and secretary, treasurer and sales manager. They never suggested to the Board of Directors that they were entitled to payment on the basis of the value of their services. The value of their services was never considered. Furthermore, they put up no claim in this action either by cross-complaint or counter-claim or otherwise that there should be a determination of the value of their services as self-styled inventors. They themselves determined what they should receive in the capacities as shown by the minutes, and that was the end of it. They had no authority to, themselves, pass upon the value of their own services. Such right would be one only to be exercised by an independent board or this Court.

(d) The defendants were not rendering services by way of inventions. At best, certain property rights were transferred to the corporation. Furthermore these property rights were not worth anywhere near the consideration claimed by the defendants, whether in the form of salaries, or otherwise. These matters have been heretofore adequately considered.

IV. THE POWER OF THIS COURT TO REVERSE.

Counsel from pages 8 to 20 of their brief proper and from pages 1 to 10 of their appendix delve into a mass of cases having to do with whether the present action is one at law or in equity. They conclude that this is an action at law. Their conclusion is erroneous. (*Moon Motor Car Co. v. Moon,* 58 Fed. Rep. (2d) 90; *Wright v. Heublein,* 238 Fed. 321; *Green v. Felton,* 42 Ind. App. 675, 84 N. E. 166; *Raynolds v. Diamond Paper Mills Co.,* 69 N. J. Eq. 299, 60 Atl. 941; *Davis v. Thomas A. Davis Co.,* 63 N. J. Eq. 572, 52 Atl. 717; *Sotter v. Coatesville Boiler Works,* 257 Pa. 411, 101 Atl. 744.)[6]

We do not pursue the discussion. The question is moot. The third sentence of Rule 52 of the Rules of

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[6]Counsel mention that plaintiff has sought a joint judgment against both defendants. Although this is not material to the burden of proof, it is perfectly proper under the authorities. All directors who participate in the payment of illegal salaries are liable, even though they may not receive salaries themselves. In this case both Burrel and Armington, although not sued, were equally liable. *Atwater v. Elkhorn Valley Coal Land Co.,* 171 N. Y. S. 552; *Eshleman v. Keenan,* 21 Del. Ch. 259, 187 Atl. 25.

Civil Procedure for the District Courts of the United States is the answer. It states that if findings of fact are clearly erroneous they should be set aside. The rule adopted the modern Federal equity practice and is applicable to all classes of findings in cases tried without a jury, whether or not the finding is of a fact concerning which there was conflict of testimony or of a fact deducted or inferred from uncontradicted testimony. We stress, however, that there is no conflict in the facts upon which we rely, namely, the amount of defendants' salaries, the percentage of net profits which was thereby consumed, the ratio the salaries bore to the entire capital and surplus of the company, the years during which the so-called inventions were perfected, the lack of any authorization or contract for the employment of defendants as inventors, and so on.

We can do no better than quote from the Notes of the Advisory Committee appointed by the Supreme Court (Manual of Federal Procedure, p. 324), as follows:

> "See Equity Rule 70½, as amended Nov. 25, 1935 (Findings of Fact and Conclusions of Law), and U.S.C.A., Title 28, Sec. 764 (Opinion, findings, and conclusions in action against United States) which are substantially continued in this rule. The provisions of U.S.C.A., Title 28, Secs. 773 (Trial of issues of fact; by court) and 875 (Review in cases tried without jury) are superseded in so far as they provide a different method of finding facts and a different method of appellate review. The rule stated in the third sentence

of Subdivision (a) accords with the decisions on the scope of the review in modern federal equity practice. It is applicable to all classes of findings in cases tried without a jury whether the finding is of a fact concerning which there was conflict of testimony, or of a fact deduced or inferred from uncontradicted testimony. See Silver King Coalition Mines Co. v. Silver King Consolidated Mining Co., 204 Fed. 166 (C.C.A. 8th, 1913), cert. den. 229 U. S. 624, 33 S. Ct. 1051, 57 L. Ed. 1356 (1913); Warren v. Keep, 155 U. S. 265, 15 S. Ct. 83, 39 L. Ed. 144 (1894); Furrer v. Ferris, 145 U. S. 132, 12 S. Ct. 821, 36 L. Ed. 649 (1892); Tilghman v. Proctor, 125 U. S. 136, 149, 8 S. Ct. 894, 31 L. Ed. 664 (1888); Kimberly v. Arms, 129 U. S. 512, 524, 9 S. Ct. 355, 32 L. Ed. 764 (1889). Compare Kaeser & Blair Inc. v. Merchants' Ass'n, 64 F. 2d 575, 576 (C.C.A. 6th, 1933); Dunn v. Trefry, 260 Fed. 147, 148 (C.C.A. 1st, 1919)."

Viewing counsel's argument from a more matter of fact angle, we add that this Court is not being asked to determine the extent of the excess of salaries. This may well be a matter for the trial Court. We are only asking this Court to state that the salaries were excessive and that the trial Court erroneously found to the contrary. This Court is in as good position to make such ruling as was the District Court. The evidence as to all matters material to this appeal was uncontradicted. *State Farm Mutual Automobile Insurance Co. v. Bonacci,* 111 Fed. 2, 412, relied upon at page 3 of the appendix to defendants' brief, recognizes the principle that where the lower court is in

no better position to judge than the appellate court, the appellate court is not bound by the findings.

The defendants during the years 1940 and 1941 extracted from the corporation salaries amounting to, respectively, 70% and 74% of the net profits. For those years they extracted salaries in an amount equivalent to one-quarter of the capital and surplus of the corporation. No increase in duties occurred.

Counsel at page 55 and elsewhere in their brief claim that the duties had been increased, due to the Bettis patent having been declared invalid; however, on page 47 of their brief they admit that the Bettis patent was declared invalid in the year 1932. The defendants are talking about the years 1932 to, at best, 1939. It is a fanciful flight of the imagination that increases in salaries made in 1939, 1940 and 1941 were on account of increases in responsibility occurring in the year 1932.

So far as counsel's argument is concerned, sometime during the year 1939 the curtain was rung down. We are talking about the years 1940 and 1941, when the peak of excessive salaries occurred. There is not one iota of testimony to justify salaries during those years, at any figures higher than would have been justified for an ordinary manufacturing business. Again we state that there is no necessity for us to rely upon the Bunch exhibit. That exhibit is only common sense, and accords with current facts. The experience and general knowledge of this Court is more than sufficient argument. Although it may surprise counsel,

cases of this type have been reversed. (*Ross v. Quinneses Mining Co.,* 227 Fed. 337; *Schall v. Althaus,* 203 N. Y. S. 36.)

V. THE BURDEN OF PROOF.

Counsel devote pages 20 to 43 of their brief and pages 10 to 20 of the appendix to an elaborate discussion attempting to establish the burden of proof to be upon the plaintiff. They resort to our claim of fraud. There may be some divergence in the authorities. We believe, however, that since the question is not one of substantive rights but one of evidence, the opinion of the United States Supreme Court should govern. We again quote from *Geddes v. Anaconda Mining Co.,* 254 U. S. 590, cited at pages 23 and 24 of our opening brief:

> "The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation, and where the fairness of such transactions is challenged the burden is upon those who would maintain them to show their entire fairness and where a sale is involved the full adequacy of the consideration. Especially is this true where a common director is dominating in influence or in character. This court has been consistently emphatic in the application of this rule, which, it has declared, is founded in soundest morality, and we now add in the soundest business policy. Twin-Lick Oil Co. v. Marbury, 91 U. S. 587, 588; Thomas v. Brownville Ft. Kearney & Pacific R. R. Co., 109

U. S. 522; Wardell v. Railroad Co., 103 U. S. 651, 658; Corsicana National Bank v. Johnson, 251 U. S. 68, 90."[7]

The point is not material. We have met the burden of proof. The real basis of recovery is the excessiveness of the salaries. Counsel has cited no opposing cases. Our view is well expressed in *Stratis v. Anderson,* 254 Mass. 536, 150 N. E. 832, and in the cases cited in that opinion, cited and quoted from at page 23 of our opening brief. For the convenience of the Court, we again quote:

> "It is immaterial in this connection whether there was actual fraud. The right of recovery for the benefit of the corporation rests upon the excessive payment to a director."

Not only the best way, but the only way to establish the excessiveness of salaries is to prove the amount thereof. Allegations and proof of other fraud may be determinative in a doubtful case but they are not essential if the mere amount of the salaries establishes their excessiveness.

Approaching this case from this angle, the mere proof of the amount of defendants' salaries was in itself sufficient to establish fraud or (if at all material to this case) to shift the burden of proof. Coun-

[7]Counsel mention sections 311 and 1963 of our California Code of Civil Procedure. Section 311 has nothing to do with the burden of proof. Section 1963 makes no mention of directors dealing with themselves. This section prescribes certain rules of evidence to be followed in state courts and, for the reason above given, would not be controlling even if this case were in a state court.

sel's own authority, *Nahikian v. Mattingly,* 265 Michigan 128, 251 N. W. 421, recognizes the foregoing, for, by the very excerpt quoted on page 11 of the appendix to defendants' brief, that case concedes that salaries can be, in themselves, so unreasonable or excessive as to be pronounced fraudulent without further proof.

Upon pages 36 and 41 of defendants' brief counsel also concede the foregoing. We quote as follows:

> "Where it clearly appeared as a matter of mathematical certainty that the consideration for the purchase assessed at its money value was inadequate, the plaintiff necessarily had sustained the burden of proof and the burden was thereupon cast upon the decedent to justify it. * * *" (Page 36)
>
> "* * * The claim was, in effect, that the discount he received for doing this and the profits he personally made in selling certain property of the corporation were excessive and unconscionable. A mere reading of the facts would seem to demonstrate that this was true. While the trial court found that the burden was on the company's receiver to prove fraud, the Appellate Court very properly holds otherwise.
>
> "The situation on the face of things showed the realization of large profits by Sisk on each of the transactions complained of which alone gives rise to a presumption that the property which he obtained from the corporation and resold was worth appreciably more than the price at which he obtained it from the corporation. * * *" (Page 41.) (Underscoring ours.)

If it is possible, let us assume a more extreme case than the one at bar. Suppose that the defendants by way of salaries for the year 1940 had extracted from the corporation the entire assets of the corporation over and above its indebtedness. The mere proof of that fact would be sufficient. In this case defendants extracted from 70% to 74% of the net profits and in each year an amount equivalent to one-quarter of the capital and surplus, all to the tune of $50,000 per year. The hypothetical case and the present case fall into the same category.

However, we are not saying that there was no other fraud. We believe that, in addition to at least the *prima facie* case made out by the very amount of the salaries, there was other fraud. This we showed in our opening brief and will hereinafter deal with the same again. This is our gratis contribution.

Counsel attempt at page 41 of their brief the argument that since Ballagh did not vote for his own increase in salary and Miller did not vote for his own increase in salary, the discretion of the Board of Directors can be upheld. Miller, however, did vote for Ballagh's increase, and Ballagh did vote for Miller's increase. The increases went hand in hand. The vote of each was given to increase the salary of the other. The language in *Angelus Securities Corp. v. Ball,* 20 Cal. App. (2d) 423, at 433, is pertinent. We quote therefrom as follows:

> "In the instant case, Woodward, Harriss, Ball and Crowe did not vote for their own salary, but

separate resolutions were introduced authorizing the salary, and while not voting for the resolution authorizing his own salary, each of the last-named directors voted for the resolutions authorizing a salary for the others. Six directors were necessary to constitute a quorum, and unless, for instance, Crowe, Harriss and Woodward were qualified to vote for Ball's salary, there was not a proper vote for that salary. Where, as in the instant case, the evidence shows that directors Ball, Crowe, Harriss and Woodward were interested in the common object of procuring a salary for each of them, the situation is not saved by passing several separate resolutions by a majority not interested in the particular resolution adopted. (Wonderful Group Min. Co. v. Rand, 111 Wash. 557 [191 Pac. 631, 633]; 14A Cor. Jur. 143, 144, sec. 1908.) The weight of authority seems to be that courts will not separate a resolution into parts and hold it valid on the ground that each part was carried by a majority of the votes of the other directors not interested in that particular portion, and this applies with equal force where several resolutions are introduced upon the same theory. The fact that a resolution increasing salaries is voted on in parts, so that no director votes on the proposition to increase his own salary, does not justify the passage of the salary resolution, because the effect is merely to give a semblance of legality to a wrongful act. (Davids v. Davids, 135 App. Div. 206 [120 N. Y. Supp. 350].) As to the third cause of action the nonsuit should have been denied."

See also *Sagalyn v. Meekins, Packard and Wheat,* 290 Mass. 434, 195 N. E. 769, 771.

Counsel, by sidestepping the foregoing authorities, forget that in this case the defendants, as directors, were dealing with themselves. There is no conflict on this point. Dulin consistently voted against and vigorously protested the salary increases. The other directors, Burrell and Armington, were dominated by the defendants, and, even had they not been so dominated, the vote of Miller was given for the Ballagh raises and the vote of Ballagh for the Miller raises. In the language of counsel, when such a showing is made (if the burden of proof was ever upon the plaintiff) the burden shifted to the defendants.

At page 40 of defendants' brief in commenting upon *Church v. Harnit,* 35 Fed. (2d) 499, the following appears:

> "* * * In other words, the directors who voted the bonus to Harnit in the first place were, in fact, voting a bonus to themselves since it was understood in advance that Harnit would pay portions of the bonus voted to him to them and, under these circumstances, the Court holds that the burden was upon the directors voting for the bonuses which they eventually received to show that they were fair and reasonable."

After the foregoing, there appears upon page 41 of counsel's brief the following:

> "* * * This is simply another of many cases which hold that where a director does himself par-

ticipate in the vote affording him increased compensation without a corresponding increase in his duties and responsibilities, the burden is cast upon him to establish his fair dealing, which is not at all the case at bar."

On page 42 counsel further state:

"* * * Here again is a case, of which there are many, which lays down the rule that where the beneficiary of the vote participates in the voting, the courts will scrutinize the action of the board and the burden is shifted to the participating director to establish the fairness of the board's action."

Also worthy of further comment is that in the excerpt from defendants' brief above quoted from page 41 thereof they admit that a director who votes for a resolution increasing his own compensation without corresponding increase in his duties and responsibilities takes over the burden of proof. Here, there was no increase in duties or responsibilities.

At page 22 of our opening brief we showed the control that the defendants exercised over the corporation.[8] At pages 5 and 48 of our opening brief

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[8]In an attempt to argue against what has been firmly established by the record that the defendants exercised complete control over the corporation, counsel mentioned certain circumstances, to-wit:

(a) They claim that the defendants managed the corporation "subject to the direction of the Board". This may be correct, but the defendants were the Board. Burrell and Armington only acted for these defendants. No majority could be obtained unless Miller or Ballagh voted.

(b) They claim that the defendants were very solicitous of the prerogatives of Dulin as a director. The defendants certainly were

we pointed out that just as soon as Miller bought into the corporation he not only proceeded to increase salaries, but also repudiated all obligation to pay plaintiff royalties under Exhibits 15A, 15B, 15C and 15D (R. 222; 229; 336; 359; 382),[9] and also refused the payment of any further dividends (R. 68; 245; 255; 382). In other words, in accordance with the authorities cited on page 49 of our opening brief, the defendants were resorting to the unlawful practice of distributing corporate profits in the guise of compensation.

If anything further is required to establish fraud, we again refer to our argument at page 51 of our

not solicitous when it came to fixing their own salaries and that they may have been in other respects is immaterial.

(c) They argue that on one occasion both Patterson and Rennie voted with Dulin. Patterson ceased to be a director when defendant Miller bought into the Company and Rennie over the protest of Dulin was thrown off the Board at the meeting of February 2, 1939. He was not the type of director that the defendants wanted.

(d) They argue that Dulin voted for certain increases of salary (not those attacked in this case). These increases occurred in October of 1938, and March of 1939. Neither of these raises could be material; furthermore, their peak was $1,500 per month, which is a far cry from the amount of defendants' salaries during 1940 and 1941.

It may well be that Dulin was too liberal in voting for the increases for which he did vote and as above mentioned. It may well be that his action was in an attempt to keep peace in the family trusting that the defendants might thereby be persuaded to treat the minority stockholders to some extent in a fair manner. The truth is that the subsequent increase of salaries over the objections of Dulin got out of all bounds—thus this present action.

[9]As mentioned on page 48 of our opening brief, Mr. Judge Hollzer held that the repudiation of royalties by the defendants was wrongful. That case is now on appeal entitled "Patterson Ballagh Corporation, Appellant, vs. Byron Jackson Co., Appellee" and is numbered 10,553 upon the records of this court.

opening brief, namely that Ballagh testified that the defendants did not consider their cash on hand adequate to pay dividends (R. 361); nevertheless, they raised their own salaries and in so doing, admittedly by their testimony, took into consideration the fact that they were not paying dividends (R. 358; 363; 382). If more is needed, we again refer to the Miller letter of August 22, 1939 which was sent about the time that the conspiracy between Ballagh and Miller was hatched. We again quote from that letter:

> "Since assuming office as President of Patterson-Ballagh Corporation I have taken upon myself the duty of studying the various costs in connection with the conduct of this business. I find that for the first six months of 1939, the corporation will show a loss of some $2,000. (R., 223.)"

We cannot conceive that any stronger evidence of fraud could be produced in a case of this character, except possibly by the express admissions of fraud by the defendants themselves.

Fraud need not consist of being caught "red-handed", with a marked bill or a "rubber check". The fraud in this case was of the type that simmered and planned and conspired and then burst into flame.

VI. RATIFICATION AND WAIVER.

Counsel devote two pages, to-wit 76 and 77, of their brief to the contention of ratification and waiver. They overlook three very pertinent elements:

1. The conclusions of law of the trial judge held that a waiver existed only for the period from January 1, 1941 to September 10, 1941.

2. Counsel neglect the long line of authorities (as to which we know none in opposition) that majority stockholders are bound to exercise the same good faith as majority directors, and may not, for selfish purposes, act in hostility to the interests of the corporation with the intent of defrauding the non-assenting stockholders. We quote from *Godley v. Crandall & Godley Co.,* 212 N.Y. 121, 105 N.E. 818:

> "A majority of the stockholders, consisting of those who had received the preferential payments, voted after the commencement of this action to ratify the acts of the directors. But even majority stockholders may not for selfish purposes act in hostility to the interests of the corporation with the intention of defrauding the non-assenting stockholders. Gamble v. Queens County Water Co., supra; Farmers' Loan & Trust Co. v. N. Y. & N. Ry. Co., 150 N. Y. 410, 44 N. E. 1043, 34 L. R. A. 76, 55 Am. St. Rep. 689; Flynn v. Brooklyn City R. R. Co., supra; Continental Securities Co. v. Belmont, 206 N. Y. 7, 99 N. E. 138, Ann. Cas. 1914A, 777. The recovery under this head, as modified by the Appellate Division was proper."

We also cite: *Atwater v. Elkhorn Valley Coal Land Co.,* 171 N. Y. S. 552; *Collins v. Hite,* 109 W. Va. 79, 153 S. E. 240; *Barrett v. Smith,* 185 Minn. 596, 242 N. W. 392; *Sotter v. Coatesville Boiler Works,* 257 Pa. 411, 101 Atl. 744, p. 747.

3. Also, the following appears in the minutes of the annual meeting of shareholders held January 21, 1941, the meeting at which the waiver and ratification was supposed to have occurred, to-wit:

> "Thereupon, on motion of J. C. Ballagh, seconded by D. G. Miller and carried, E. S. Dulin voting in the negative, it was
>
> > Resolved, that all action taken by the Board of Directors of this corporation since the date of the last annual meeting of the shareholders, whether said Directors were de facto or de jure, and all action of the officers of this corporation done pursuant to the authorization of the Board of Directors or with the knowledge and acquiescence of the Directors are hereby ratified, approved and confirmed as and for the corporate acts of this corporation.
>
> > E. S. Dulin explained his vote in the negative on the foregoing resolution by stating that in his opinion the acts of the officers and Directors in accepting and fixing the amount of compensation paid during the last fiscal year to the President and Secretary was contrary to the best interests of the minority shareholders."

We respectfully submit that the judgment should be reversed and the cause remanded for a new trial.

Dated, San Francisco, California,
November 26, 1943.

Chickering & Gregory,
Donald Y. Lamont,
Frederick M. Fisk,
Stephen R. Duhring,
Lyon & Lyon,
Leonard S. Lyon,
Irwin L. Fuller,
Attorneys for Appellant.

The case of Caminetti v. Prudence Mutual Life Ins. Assn., 61 A. C. A. 67, quoted in full in the following appendix has just come to the attention of the writer of this brief. It is too late to argue from the same. The case, however, involves so many similar points that we set it forth at length without comment.

Appendix.

Appendix

(Vol. 61 A. C. A. 67.)

In the District Court of Appeal
State of California
Second Appellate District

Division Three

2 Civil No. 13,918

A. Caminetti, Jr., as Insurance Commissioner, etc.,
Appellant,
vs.
Prudence Mutual Life Insurance Association (a corporation),
Respondent.

[1a, 1b] . **Insurance—Corporations—Insolvency—Conservator — Termination — Appeal—Harmless and Reversible Error.**—On hearing of an application to terminate the Insurance Commissioner's conservatorship over the property and business of an incorporated insurance association, an erroneous ruling that the commissioner was required to proceed first with the production of evidence was not a ground for reversal where all of the evidence of both parties was fully presented.

[2] **Appeal — Presumptions — Evidence—Burden of Proof.**—Where the trial court vacated an erroneous ruling on the burden of proof, it will be presumed on appeal that the court thereafter considered the evidence in the light of the proper rule as to burden of proof.

[3] **Insurance—Corporations—Insolvency—Conservator—Termination—Rules of Procedure.**—An application under Ins. Code, § 1012, to terminate the Insurance Commissioner's conservatorship over the property and business of an incorporated insurance association is a special statutory proceeding, and the rules of procedure for ordinary civil actions do not apply to such proceeding of their own force.

[4] **Id. — Corporations — Insolvency—Conservator—Application.**—No provision having been made for an appearance in response to a verified application for conservatorship filed by the Insurance Commissioner under Ins. Code, § 1011, that application is evidently not a complaint to be answered.

[5] **Id.—Corporations — Insolvency — Conservator—Termination—Application.**—If an incorporated insurance association desires vacation of an order appointing the Insurance Commissioner as con-

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McK. Dig. References: [1, 3-8, 15-17] Insurance, § 11; [2] Appeal and Error, § 1136; [9, 12] Corporations, § 595; [10, 11] Corporations, § 595; Husband and Wife, § 61; [13] Compromise and Settlement, § 1; [14] Insurance, § 234.

servator of its property and business, the association must present its own application therefor.

[6] **Id.—Corporations — Insolvency—Conservator—Termination—Nature of Proceeding.**—A proceeding to terminate the Insurance Commissioner's conservatorship over the property and business of an incorporated association is not like that of an order to show cause and restraining order issued to one seeking an injunction. The commissioner need do nothing after the order appointing him as conservator, and if the association does nothing the order continues in force indefinitely.

[7] **Id.—Corporations — Insolvency—Conservator—Termination—Evidence—Burden of Proof.**—In a proceeding under Ins. Code, § 1012, the burden of proof is on the corporation challenging continuance of the Insurance Commissioner's conservatorship over its property and business, to make it "appear to the court" that there are proper reasons for setting aside the conservatorship.

[8] **Id.—Corporations — Insolvency—Conservator—Persons Affected.**—The word "person," as used in Ins. Code, § 1011, enumerating the conditions affording ground for an order appointing the Insurance Commissioner as conservator of an insurance company, includes corporations and associations.

[9] **Corporations—Officers—Vote of Interested Director.**—The former rule that a corporation director was disqualified from voting on any matter in

which he was directly and personally interested, was modified by the adoption of Civ. Code, § 311, which declares that no transaction between a corporation and one of its directors shall be void because such director is present at the meeting at which the transaction is authorized, if, among other things, the fact of his interest is known to the board and the transaction is authorized by a vote sufficient without counting that of such director.

[10] **Id.—Officers—Vote of Interested Director: Husband and Wife—Property—Community and Separate—Husband's Salary.**—The resolutions of a corporation board of directors consisting of three persons, of whom a husband and wife were two, fixing the salary of the husband, and a subsequent resolution authorizing the compromise of his claim for back salary, were not passed by a majority sufficient for that purpose without his vote, and the transaction could not be upheld under Civ. Code, § 311(a). The wife's vote could not be counted to carry the resolution fixing her husband's salary, as such salary would be community property under Civ. Code, § 164, and by virtue of Civ. Code, § 161a, she would have a present and equal interest therein.

[11] **Id.—Officers—Vote of Interested Director: Husband and Wife—Property—Community and Separate—Wife's Earnings.**—Where two of the three

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[9]See 6A **Cal.Jur.** 1107; 13 **Am.Jur.** 955.

directors of a corporation were husband and wife, and where the resolution compromising the wife's salary claim and that of the husband came up for action in the same meeting, they were interested in the common object of obtaining more salary for each of them and were both disqualified to vote on either resolution. The husband, however, was not disqualified to vote on the original resolutions fixing the wife's salary where they were living apart at the time, as her earnings during such period would be her separate property under Civ. Code, § 169.

[12] **Id.—Officers—Compensation—Implied Contract.** —An officer who renders beneficial services to a corporation, without any lawful action of the board of directors fixing his compensation, but under circumstances negativing an intent that they were to be gratuitous, may recover the reasonable value of those services. But no recovery may properly be allowed for such services where there is no evidence that the services rendered to the corporation by the officer, during the time to which his claim for back salary relates, were worth more than he had received for them.

[13] **Compromise and Settlement—Good Faith of Parties.**—The rule that a compromise of a claim asserted in good faith is valid even though the claim is actually without legal foundation, has no application where the claimants, acting as fiduciaries for the adverse party, approve the com-

promise of their own claims and the approval fails for that reason.

[14] **Insurance—Contribution.**—The fact that a husband and wife, who were paid the amount of a compromise of their claims for back salaries as officers of an incorporated insurance association, had agreed to make a "contribution" of the amounts received to the association under Ins. Code, § 10745, did not prevent any part of the payments on the compromise from being a diversion of the association's assets, where the "contribution," was not a gift, but an advancement, to be repaid to the contributor when the condition of the association should warrant.

[15] **Id.—Corporations—Insolvency—Conservator—Wrongful Diversion of Corporation's Assets.**—Payments to officers of an incorporated insurance association upon an unauthorized compromise of their claims for back salaries, constitute a wrongful diversion of the association's assets, within the meaning of Ins. Code, § 1011, subd. (h). It is not necessary that the wrongful diversion should be akin to embezzlement, as the word "embezzlement" appears in the statute in addition to the words "wrongfully diverted," and under the rule of statutory construction, that meaning and effect are to be given to every word and clause of a statute, the ordinary meaning of the words "wrongfully diverted" is sufficient for that purpose.

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[15] See 23 **Cal.Jur.** 758.

[16] **Id.—Corporations—Conservator — Termination —Evidence—Burden of Proof.**—An incorporated insurance association seeking to terminate the Insurance Commissioner's conservatorship over its property and business has the burden of proving that it can properly resume title and possession of its property and the conduct of its business, as required by Ins. Code, § 1012. Whether there is evidence to justify a finding for the association on this issue is a matter primarily for the consideration and the discretion of the trial court, whose decision is binding on appeal unless without any support in the evidence.

[17] **Id.—Corporations—Conservator — Termination —Construction of Statute Authorizing.**—In Ins. Code, § 1102, requiring, as a prerequisite to an order terminating the Insurance Commissioner's conservatorship of an insurance corporation, that the ground on which he was made conservator "does not exist or has been removed," the words "does not exist," although couched in the present tense, refer to the time when the order appointing the conservator was made; otherwise there would be no use in the statute for the other alternative, "or has been removed."

APPEAL from a judgment of the Superior Court of Los Angeles County. Thurmond Clarke, Judge. Reversed.

Application by insurance association to terminate conservatorship of Insurance Commissioner over its property and business. Judgment dissolving conserv-

atorship and directing restoration of property and business to insurance association, reversed.

Robert W. Kenny, Attorney General, and John L. Nourse, Deputy Attorney General, for Appellant.

Chas. R. Thompson, Sherman & Sherman and Ralph H. Lewis for Respondent.

SHAW, J. pro tem.—Appellant, as Insurance Commissioner of the State of California, obtained from the Superior Court of Sacramento County an order under section 1011 of the Insurance Code appointing him as conservator of the business of the respondent, Prudence Mutual Life Insurance Association, and pursuant to this order took over its property and business. The respondent is a corporation organized to do life insurance business on the mutual benefit assessment plan. Corporations of this class are usually referred to in the Insurance Code as "associations." As soon as this order was made, the proceeding was transferred to Los Angeles County. Later, on application of respondent, a hearing was had under section 1012 of the Insurance Code, at the conclusion of which the Superior Court of Los Angeles County entered a judgment cancelling and terminating the former order, dissolving the conservatorship and directing the restoration to respondent of its property and business. From this judgment the Insurance Commissioner appeals.

[1a] At the outset of the hearing the trial court was asked to rule upon the question where lay the burden of proof, and after extended argument it announced its opinion that the burden rested on the In-

surance Commissioner. Appellant now complains of this as reversible error. The court's declaration of law, although erroneous, as will presently appear, does not in itself afford ground for a reversal, under the circumstances of this case. As a result of this declaration the commissioner's evidence was produced first, but it does not appear that either party was prevented by it from producing all available evidence, or desired to or could obtain or present anything further. The hearing appears to have been a "full hearing," as required by section 1012 of the Insurance Code. **[2]** After the taking of evidence, and just before the entry of judgment, the trial court made an order vacating the submission of the case and reopening it for the purpose of making and did make a further order vacating its ruling on the burden of proof and declaring that it had heard, considered and weighed all of the evidence of both parties and that "regardless of where the burden of proof lay, the decision of this court would not be affected." This order was made seven days after the filing of the first of the decisions on burden of proof hereinafter cited and we are informed by the briefs that it was made by reason of that decision. However that may be, it shows that the court vacated its ruling on the burden of proof. We must therefore presume, nothing now appearing to the contrary, that the court weighed and considered the evidence in the light of the proper rule as to the burden of proof. **[1b]** The only remaining effect of its former ruling is that the appellant was required to proceed first with the production of evidence. But an error in that respect does not ordi-

narily result in a miscarriage of justice, where all the evidence of both parties is fully presented, and we think it did not here.

In spite of this conclusion it is necessary for us to deal with the question of the burden of proof, for appellant contends that there is no proof of various facts essential to the support of the judgment, that respondent had the burden of proving those facts, and that the lack of proof of them requires a reversal. The Insurance Code contains, in article 14 of chapter 1, part 2, division 1, comprising sections 1010 to 1062, elaborate provisions for proceedings in case of insolvency or delinquency of "persons" (defined by section 19 to include associations and corporations) doing insurance business. Section 1011 provides that the Superior Court "shall, upon the filing by the commissioner of the verified application showing any of the following conditions hereinafter enumerated to exist" make an order vesting in the commissioner title to all the assets of an insurance company and directing him to take possession of its records and assets, and to conduct, as conservator, its business. This application must be served on the company ("person") in the same manner as a summons (sec. 1040), but no provision is made for an answer to it, and the order mentioned in section 1011 is obviously to be made ex parte on the filing and presentation of the application. Section 1012 provides as follows: "Said order shall continue in force and effect until, on the application either of the commissioner or of such person [company], it shall, after a full hearing, appear to said court that the ground for said order

directing the commissioner to take title and possession does not exist or has been removed and that said person can properly resume title and possession of its property and the conduct of its business."

[3] It is clear that what we have here is not an ordinary civil action, but a special statutory proceeding. None of the rules of procedure for such actions are made applicable to it by the statute (except as already noted) and they do not apply to it of their own force. (*Carpenter v. Pacific Mut. Life Ins. Co.,* (1937) 10 Cal.2d 307, 327-8 [74 P.2d 761]; *Carpenter v. Pacific Mut. L. Ins. Co.,* (1939) 13 Cal.2d 306, 311 [89 P.2d 637].) **[4]** No provision is made for an appearance in response to the verified application filed by the commissioner under section 1011, and that application is evidently not a complaint to be answered. **[5]** The company, if it desires a vacation of the order, must present its own application therefor. While the statute does not require it to state in such application any reasons for vacation of the order, no doubt it may do so. Such reasons may or may not include a negation of the grounds of the order, but if they do it comes as the claim or contention of the company so applying. The original application of the commissioner has served its purpose when an order has been made upon it, except as a place of reference to ascertain the grounds of the order.

[6] Nor is the proceeding at all like that in case of an order to show cause and restraining order issued to one seeking an injunction. Such a party is the actor and must proceed with his proof or lose his restrain-

ing order. Here the commissioner need do nothing after obtaining the order appointing him as conservator; and if the company does nothing the order continues in force indefinitely.

Even if the company obtains a hearing, the order, by the terms of section 1012 "shall continue in force and effect until . . . it shall, after a full hearing, appear to said court" that for the reasons stated in this section it should be set aside. If at the hearing there is no evidence at all, or the evidence presented is insufficient to prove, that is, make it "appear to the court," that there are proper reasons for setting aside the order made under section 1011, the company, if it is the applicant for such relief, must fail. **[7]** A statutory provision with this effect places the burden of proof on the party who must meet its requirements to succeed. This is in conformity to the provisions of section 1981, Code of Civil Procedure, that "the burden of proof lies on the party who would be defeated if no evidence were given on either side." The same conclusion has been reached, for somewhat different reasons, with which, also, we agree, in *Caminetti v. Guaranty Union L. Ins. Co.* (1942) 52 Cal.App.2d 330, 337 [126 P.2d 159], and *Caminetti v. Imperial Mut. L. Ins. Co.,* (1943)[1] 59 Cal.App.2d 476, 487 [139 P.2d 681].

Section 1011 of the Insurance Code enumerates among the conditions, the existence of which affords ground for an order appointing the Insurance Commissioner as conservator of an insurance company, the

[1]Advance Report Citation: 59 A.C.A. 584, 595.

following: "(d) That such person is found, after an examination, to be in such condition that its further transaction of business will be hazardous to its policy holders, or creditors, or to the public. . . . (h) That any officer or attorney-in-fact of such person has embezzled, sequestered, or wrongfully diverted any of the assets of such person." [8] The word "person" here, as elsewhere in the code, by definition includes corporations and associations. The commissioner's application for the order in this case stated as a ground therefor that two of the officers of respondent, Charles E. Fielder and his wife, Eunice H. Fielder, had wrongfully diverted assets of the association to themselves. This charge is based on the compromise and payment of claims for back salary made against the association by them. During the whole time covered by the inquiry Charles E. Fielder was a director and general manager of the association and also held either the office of president or that of secretary and his wife, Mrs. Eunice H. Fielder was office manager and vice president and also a director. In February of 1931, 1932, 1933 and 1934, the board of directors of the association consisted of three persons, of whom Mr. and Mrs. Fielder were two, and in each of these months the board adopted a resolution fixing the salary of the "secretary and general manager" at $400 per month and another resolution fixing the salary of the "vice president and assistant secretary" at $200 per month. Apparently all the directors voted for all of these resolutions. The next action taken by the board of directors on officers' salaries was a resolution

adopted on September 7, 1935, fixing the salaries of the officers at a maximum of $200 per month "during the existing emergency." In August, 1935, Mr. and Mrs. Fielder signed waivers of all unpaid salaries up to July 31, 1935. No further action regarding officers' salaries was taken up to the time of the compromises hereinafter mentioned. From July 31, 1936, to August 1, 1939, C. E. Fielder drew a salary of $200 per month and Mrs. Fielder drew a salary of $75 per month. On September 5, 1939, Mr. and Mrs. Fielder presented to the board of directors claims for back salaries, Mr. Fielder's for $5,000, and Mrs. Fielder's for $4,775, each of them also making an offer to compromise for $2,550. On September 13, 1939, the board of directors, at a meeting at which Mr. and Mrs. Fielder and one other director were present, adopted separate resolutions, for which all the directors voted, authorizing the acceptance of these offers of compromise and the compromise of each of these claims for $2,550. Following these resolutions the amounts of the compromises were paid to Mr. and Mrs. Fielder.

[9] The law in California formerly was that a director was disqualified from voting on any matter in which he was directly and personally interested and could not be one of a majority essential to the adoption of such a resolution. (6A Cal.Jur. 1107; *Angelus Securities Corp. v. Ball,* (1937) 20 Cal.App.2d 423, 432, [67 P.2d 152].) That rule was somewhat modified by the adoption of section 311 of the Civil Code, which as it now stands declares that no contract or other transaction between a corporation and one of

its directors, or between a corporation and any corporation, firm or association in which one of its directors is financially interested, shall be void or voidable by reason of the fact that such director is present at the meeting at which the contract or transaction is authorized or approved or that his vote is counted for that purpose, if (a) the fact of his interest is known to the board and the contract or transaction is authorized or approved by a vote sufficient without counting that of such director, or (b) the contract or transaction is approved or ratified, with knowledge of the director's interest, by a majority of the shareholders, or (c) the "contract or transaction be just and reasonable as to the corporation at the time it was authorized or approved."

[10] It is clear that, as far as Mr. Fielder is concerned, the original resolutions fixing his salary and the resolution authorizing the compromise were not passed by a majority sufficient for that purpose without his vote, and hence the transaction cannot be upheld under subdivision (a) of section 311, above referred to. His salary, as well as any amount received in compromise of a claim therefor, would be community property (Civ. Code, sec. 164), and by virtue of section 161a of the Civil Code, adopted in 1927, his wife would have a present, existing and equal interest therein. Possibly Mrs. Fielder's vote on her husband's salary is not within the letter of section 311 of the Civil Code, since he is neither a corporation, a firm nor an association; but if not, it is within the rule which governed prior to the adop-

tion of that code provision and there is nothing in section 311 to prevent the continuing application of the former rule to cases not within the purview of this section. In either case Mrs. Fielder's vote could not be counted to carry the resolution fixing her husband's salary. *Cuneo v. Giannini,* (1919) 40 Cal. App. 348 [180 P. 633], which appears to hold to the contrary, was decided before the adoption of section 161a of the Civil Code.

It is to be noted also that while the salary fixing resolutions under which Mr. Fielder made his claim fixed the salary of the "secretary and general manager," which positions he held when the resolutions were passed, he ceased to be secretary and became president on November 3, 1937, and so remained until August 3, 1939. This interregnum extended over nearly the whole period of time for which he claimed back salary, and during it the salary fixing resolutions above mentioned did not cover him. Apparently there was no resolution fixing a salary for the president alone or for the general manager alone, or for both officers together.

[11] Mrs. Fielder's vote for the compromise of her husband's claim also fails for another reason. The resolutions compromising her salary claim and that of Mr. Fielder came up for action at the same meeting. Before this meeting they talked the matter over and agreed to both compromises. They thus became interested, if they were not before, in the common object of obtaining more salary for each of them and were both disqualified to vote on either resolution.

(*Angelus Securities Corp. v. Ball, supra,* (1937) 20 Cal.App.2d 423, 433.)

For the reason last stated Mr. Fielder was also disqualified from voting on the resolution compromising Mrs. Fielder's claim. Apparently he was not interested in her salary as community property, and hence was not disqualified to vote on the original resolutions fixing her salary. Both parties state in their briefs that Mr. and Mrs. Fielder were living separate and apart and while they give us no record reference for that fact and we have found none, we are disposed to accept the fact thus agreed on. Her earnings while she is living separate from her husband being her separate property (Civil Code, sec. 169), he would not be disqualified from voting upon them.

The compromise was not submitted to the shareholders—indeed, this corporation had no shareholders —and hence is not affected by subdivision (b) of section 311 of the Civil Code. **[12]** Respondent contends that it may be upheld under subdivision (c) on the ground that it was just and reasonable as to the corporation. As to that, we begin with the fact that there was no valid resolution fixing the salary of Mr. Fielder. However, it is held that an officer who renders beneficial services to a corporation, without any lawful action of the board of directors fixing his compensation, but under circumstances negativing an intent that they were to be gratuitous, may recover the reasonable value of those services. (*Bassett v. Fairchild,* (1901) 132 Cal. 637 [64 P. 1082, 52 L.R.A.

611]; *Andrews v. Glick,* (1928)205 Cal. 699 [272 P. 587].) Respondent seeks to support the judgment here under this rule. However, we can find no evidence which would support a finding that the services rendered to the corporation by Mr. Fielder during the time to which his claim for back salary relates were worth more than he had received for them. Since the burden of proof was upon respondent in this proceeding, a defect of proof in this respect would require a finding against respondent. While the respondent states in its brief that the record "is replete with testimony of what duties they [the Fielders] performed," no reference is made to any such testimony and we have discovered none. There is testimony showing that respondent was in bad condition financially at the beginning of this period and in greatly improved condition at the end of it. But this is not enough. We find nothing showing how much time, effort and attention on the part of the officers were necessary or applied to produce such a result. The association was a small one and its administration may have been a part time job. It does appear that the salaries claimed by the two officers would, for most of the period covered by their claims, amount to 20 per cent or more of the income of the association. It further appears that no liability for these back salaries was set up on the books of the association or mentioned in any of its published statements of condition; and that Mr. and Mrs. Fielder received and accepted the salaries paid them without manifesting any objections to them.

[13] Respondent also attempts to support the compromises by reference to the rule that a compromise of a claim asserted in good faith is valid even though the claim is actually without legal foundation. That rule can have no application in a case like this where the claimants, acting as fiduciaries for the adverse party, approve the compromise of their own claims and the approval fails for that reason.

[14] Respondent further claims that the payment of these sums to Mr. and Mrs. Fielder did not constitute a diversion of the association's assets because they had agreed [with each other] to make a "contribution" of the amounts received (less $50 each) to the association under section 10745 of the Insurance Code. However, this arrangement for a "contribution" did not prevent any part of the payments on the compromise from being a diversion. The "contribution" was not a gift, but an advancement, to be repaid to the contributor when the condition of the association should warrant. Section 10745, under which the contributions would be made, while it provides that the "obligation to return such money shall not be a liability or claim . . . against the association" also provides that the "return of such money . . . shall be payable only out of surplus remaining after providing for all required reserves, surplus, or minimum funds and other liabilities, whether required by the laws of this State or any other State in which the association does business," and section 10748, relating to the same subject, provides that when such an association discontinues business, after all claims and

liabilities are paid or provided for "any surplus shall be returned to the person who advanced it."

[15] Respondent also argues that these payments to officers of the association upon the unauthorized compromise of their claims, which in the case of at least one of them appear to be without any legal foundation, do not constitute a wrongful diversion of the assets of the association within the meaning of Subdivision (h) of 1011 of the Insurance Code, the contention being that "the wrongful diversion would have to be akin to embezzlement and be of a deliberate fraudulent or felonious nature." One answer to this argument is, that the statute, in describing the acts which subject an insurer to seizure, uses the words "embezzled" and "sequestered" in addition to "wrongfully diverted." Since the word "embezzled" thus appears in the statute, we must, following the rule of statutory construction that meaning and effect are to be given to every word and clause of a statute, if that is reasonably possible (23 Cal.Jur. 758-9), seek some meaning other than that of embezzlement for the words "wrongfully diverted." The ordinary meaning of the words is sufficient for that purpose. The payment of funds of the association to the two officers constituted a diversion of those funds to them, and since there was no legal authority for the payment, the diversion was wrongful. Nothing further was needed to bring the case within the statutory provision in question. (See *Wickersham v. Crittenden,* (1892) 93 Cal. 17, 32 [28 P. 788]; same case, (1895) 106 Cal. 327 [39 P. 602];

also *People v. Talbot,* (1934) 220 Cal. 3, 15 [28 P.2d 1057].)

[16] Finally, section 1012 of the Insurance Code, requires that before an order such as that here appealed from can be made it shall appear that the insurer "can properly resume title and possession of its property and the conduct of its business." On this issue, also, the respondent had the burden of proof, and appellant insists that there is no evidence justifying a finding in respondent's favor thereon. This is a matter primarily for the consideration and discretion of the trial court, whose decision is binding on appeal unless without any support in the evidence. (*Caminetti v. Guaranty Union L. Ins. Co., supra,* (1942) 52 Cal.App.2d 330, 336 [126 P.2d 159]; *Caminetti v. Imperial Mut. L. Ins. Co., supra.* (1943) 59 Cal.App.2d 476, 486 [139 P.2d 681].) While there is evidence here which would have supported a finding against the respondent on this issue, we cannot say there is no reasonable view of the evidence which would support the trial court's implied finding in its favor. However, this conclusion does not require us to affirm the judgment. **[17]** Section 1012 of the Insurance Code further requires, as a prerequisite to such an order as we have here, a showing, in the alternative, that the ground on which the commissioner was made conservator "does not exist or has been removed." The first of these alternatives, "does not exist," although couched in the present tense, undoubtedly refers to the time when the order appointing the conservator was made. If it were not

so construed, there would be no use in this provision for the other alternative, "or has been removed," for a condition that has been removed necessarily does not exist. This would again run counter to the rule of construction above mentioned, that meaning and effect shall be given every word of a statute. As we have already shown, the ground of action existed here when the order was made; and there is no showing that it has been removed, for the diverted funds appear to be still diverted. We are not undertaking here to decide whether such an act of diversion, once done, can be undone so as to remove the ground of such an order. We merely suggest the question as one which may require future consideration.

The judgment appealed from is reversed.

Shinn, Acting P. J., and Wood (Parker), J., concurred.

Filed October 18, 1943,
James E. Brown, Clerk.